BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

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In the Matter of

Establishment of Rules to Prohibit the Imposition of Unjust, Onerous Termination Penalties on Customers Choosing to Partake of the Benefits of Local Exchange Telecommunications Competition) CC Docket No. 99-142

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JOINT COMMENTS OF THE ASSOCIATION FOR LOCAL TELECOMMUNICATIONS SERVICES, NET2000 COMMUNICATIONS, INC., AND TELIGENT, INC.

The Association for Local Telecommunications Services ("ALTS"), Net2000 Communications, Inc. ("Net2000"), and Teligent, Inc. ("Teligent") hereby submit their joint comments in the above-captioned proceeding.[1]

I. INTRODUCTION AND SUMMARY

The Telecommunications Act of 1996 not only sought to promote telecommunications competition, but it also sought to do so rapidly. The Commission is responsible for many advances toward realization of the statutory goals. Not unexpectedly, though, barriers to competition persist and the Commission must remain vigilant in eliminating them. The KMC Petition brings to

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1 The Establishment of Rules to Prohibit the Imposition of Unjust, Onerous Termination Penalties on Customers Choosing to Partake of the Benefits of Local Exchange Telecommunications Competition, CC Docket No. 99-142, *KMC Telecom Inc. Petition for Declaratory Ruling* (filed April 26, 1999)("KMC Petition").

the Commission's attention one of the more pervasive remaining barriers to competition -- excessive ILEC termination penalties.[2]

Numerous ILECs have seized upon the general absence of widespread competition to exercise their monopoly power and bind customers in long-term contracts. As competition begins to develop and customers seek to take advantage of competitive telecommunications options, they find that they are locked in to their ILEC services by excessive termination penalties. These penalties hurt consumers and they harm the development of competition. More importantly, excessive ILEC termination penalties have closed substantial portions of the telecommunications consumer markets to competition.

The Commission should exercise its authority to invalidate excessive ILEC termination penalties, and should offer consumers a fresh look at contractual or tariff provisions that contain these penalties to allow competition to gain a firm foothold in the marketplace. Otherwise, the era of local monopolies will persist in contravention of the purpose of the 1996 Act.

II. EXCESSIVE ILEC TERMINATION PENALTIES CAN IMPAIR THE DEVELOPMENT OF COMPETITION.

Termination penalties can be economically justified and are not, per se, unreasonable or anticompetitive. Nor do they

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2 Section II.B. herein suggests one possible formula for determining what ILECs should be permitted to recover as part of a termination penalty. For purposes of these comments, any ILEC termination penalty that exceeds what would be recoverable by this formula should be defined by the Commission as excessive and violative of the public interest standard.

necessarily represent the possession or exercise of market power. Indeed, many CLECs include termination penalties in their customer contracts. In the absence of meaningful competition, however, termination penalties, as shown below, exhibit the negative characteristics that can slow the development of competition.

A. Excessive ILEC Termination Penalties Prevent Customers From Exercising Choice.

As an initial matter, only firms with market power can systematically require excessive termination penalties. As noted by the Supreme Court, excessive termination penalties lock-in customers to contracts and effectively remove them from the competitive marketplace.[3] Indeed, the lock-in effect is a well-established antitrust concept recognizing that consumers can be denied the benefits of competition through operation of long-term contracts.

The lock-in concept was most recently addressed by the Supreme Court in its 1992 Kodak decision.[4] Kodak was charged with seeking to impose high service costs on purchasers of its copier equipment who were locked into long-term service agreements. The Court noted consumers' lack of information about better deals, and noted that even those customers with sufficient

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3 United States v. General Dynamics Corp., 415 U.S. 486, 501 (1974)(explaining that the ability of market participants to wield competitive influence in the marketplace is reduced or eliminated by their participation in long-term requirements contracts).

4 Eastman Kodak Co. v. Image Technical Services, 504 U.S. 451 (1992).

information may suffer uneconomic exploitation from the lock-in effects. As the Court observed,

> [i]f the cost of switching is high, consumers who already have purchased the equipment, and are thus "locked in," will tolerate some level of service-price increases before changing equipment brands.[5]

Excessive termination penalties can dramatically increase the cost of switching carriers so that the effects of competitive market forces are blunted or eliminated. In such circumstances, government intervention is warranted to protect consumers and to preserve a competitive marketplace.

The issue is not theoretical. Consumers are being denied access to competitive options because the termination penalties they would incur for switching carriers are unreasonably high. For example, one ILEC customer is five years into a ten year contract -- an agreement that was signed before the 1996 Act. The amount of the contract is $3,400 per month. However, under the terms of this contract, the customer would have to pay more than $68,000 to the ILEC before switching to a competitor. Some customers are not even aware that they have risked such termination penalties. For example, one ILEC customer signed a 5 year agreement for T-1 lines, although the term of the contract was buried in the document and was not mentioned by the ILEC account manager. The customer was not aware of the term until well <u>after</u> the agreement had been signed. Many customers have expressed a desire to take advantage of the savings offered by

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5 <u>Id.</u> at 476.

competition but have explained that the termination penalties associated with their current ILEC contracts render that option too expensive.

B. The Level Of Competition Should Determine The Reasonableness Of ILEC Termination Penalties.

In considering the issues raised by termination penalties, the Commission must first decide what kinds of penalties are "unreasonable" or "excessive." A termination fee that is high may be perfectly reasonable if agreed to in arms length bargaining between two parties of relatively equal strength. But the same fee may will not be reasonable if forced upon the ultimate consumer who has no options readily available. Therefore, the Joint Commenters propose that, as a guiding principle, where termination penalties are interposed to prevent competitors from entering the market, ILECs ought not be entitled to the enforcement of those penalties. These penalties, imposed in a monopoly environment, represent an illegitimate use of an otherwise legitimate business tool. Consequently, the Commission should invalidate ILEC termination penalties that represent an attempt to or have the effect of fending off anticipated competition.

As a practical standard, the Commission should allow a fresh look at Bell Operating Company contract provisions that contain excessive termination penalties in those States for which the FCC has not yet granted the BOC Section 271 in-region interLATA authority. The fresh look opportunity should allow consumers to avoid payment of that portion of an ILEC termination fee that is in excess of what is deemed reasonable.[6] But, even after federal 271 approval is granted, it is unlikely that the market is immediately competitive statewide. Consequently, for non-BOC ILECs, and to the extent that a BOC with federal 271 approval considers a service to be competitive and beyond the scope of Section 271 inquiries, the FCC should require ILECs to seek regulatory permission to impose termination penalties for the service. The ILEC can seek this permission by petitioning the relevant State commission and making the requisite showing for the State commission to find that the ILEC service at issue is subject to sufficient competition within the State to justify allowance and enforcement of ILEC termination penalties. Where the State commissions view themselves as having authority to order fresh look opportunities, the FCC should defer to those State commission decisions insofar as such deference would be consistent with the public interest.

The invalidation of excessive termination penalties should limit the ILEC's recovery to no more than the amount that the customer would have paid for the services actually used. One possible example of how this might be accomplished is the following: if a six year contract is terminated after three years, the penalty could equal the difference between what the customer would have paid if the contract were three years and the

6 Of course, this presumes that the consumer still may be required to pay a fee. The fresh look opportunity would simply remove that portion of the fee that is excessive.

amount that the customer actually paid.[7] A method similar to this is consistent with the Commission's prior fresh look practices.[8]

III. THE COMMISSION SHOULD PROVIDE FRESH LOOK OPPORTUNITIES FOR THOSE CONSUMERS SUBJECT TO EXCESSIVE ILEC TERMINATION PENALTIES.

A. Fresh Look Is Consistent With The Commission's Duty To Further The Public Interest.

The KMC Petition notes several instances in which the Commission has adopted fresh look policies to promote the public interest.[9] From a constitutional perspective, these policies are consistent with the view that, in certain circumstances, it is appropriate for the federal government to abrogate contractual provisions that would otherwise operate contrary to the public interest.[10] In so doing, however, the federal agency must first

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7 For example, a customer may have had the option of a \$100/year plan for 6 years for a total of \$600 or a \$250/year plan paid on an annual basis. If the customer chose the six year plan and terminated the contract after three years, the penalty should equate to no more than the amount that the customer would have paid had the customer taken the year-to-year plan. Specifically, the customer should owe the ILEC \$450. Three years at \$250/year = \$750. Subtract from \$750 the \$300 that has already been paid and the customer owes \$450 more. This represents the discount that was granted for the long term contract. Of course, the ILEC also could be permitted to recover any installation costs it incurred on behalf of the customer in reliance on the long term contract.

8 See, e.g., Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, *Memorandum Opinion and Order*, 9 FCC Rcd 5154 at ¶¶ 198, 204 (1994).

9 KMC Petition at 13-14.

10 See Western Union Tel. & Tel. Co. v. F.C.C., 815 F.2d 1495, 1501 (D.C. Cir. 1987)("the Commission has the power . . . to modify . . . provisions of private contracts when necessary to serve the public interest")(citing United Gas Pipe Line

determine that such reformation or abrogation is consistent with the public interest.[11]

Providing customers with fresh look opportunities for excessive ILEC termination penalties would satisfy these standards. Namely, a fresh look opportunity for ILEC contract and tariff provisions with excessive termination penalties would promote the competitive goal of the 1996 Telecommunications Act by giving practical effect to its terms.[12] In short, it would allow consumers that entered into these contracts either without the knowledge of or existence of other competitors in the market to make informed choice once competitors exist.

B. Some State Commissions Have Adopted Fresh Look Policies.

Some States have recognized the importance of fresh look capabilities to the development of a competitive telecommunications marketplace. For example, just prior to implementation of intraLATA toll competition, the California PUC ordered Pacific Bell to provide its intraLATA MTS/WATS/800 contract customers with notice of a fresh look period during

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Co. v. Mobile Gas Service Corp., 350 U.S. 332, 344 (1956)); see also Cable & Wireless P.L.C. v. F.C.C., 166 F.3d 1224, 1231-32 (D.C. Cir. 1999).

11 United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332, 344 (1956).

12 See S. Rep. No. 230, 104th Cong., 2d Sess., at 1 (1995) (characterizing the Telecommunications Act of 1996 as being "designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition").

which the customers could terminate their intraLATA toll contract with Pacific Bell without penalties or liabilities.[13] In providing fresh look arrangements for special access and private line customers, the Florida Public Service Commission found that

> introducing competition, or extending the scope of competition, provides end users of particular services with opportunities that were not available in the past. However, these opportunities are temporarily foreclosed to end users if they are not able to choose competitive alternatives because of substantial financial penalties for termination of existing contract arrangements. A fresh look proposal will enhance an end user's ability to exercise choice to best meet its telecommunications needs.[14]

Similarly, when granting a fresh look opportunity to ILEC special contract customers, the New Hampshire Public Utilities Commission noted that "[l]ong-term contracts entered into when a monopoly is in place can have the effect of locking up a market for an extended period of time and in some cases can prevent consumers from obtaining the benefits of a competitive local exchange environment."[15] The Ohio Public Utilities Commission has also allowed a fresh look for ILEC customers with long-term contracts for basic local exchange service (or contracts in which

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13 Application of Pacific Bell for limited authority to provide MTS/WATS/800 contracts, Decision No. 93-06-032, *Opinion*, 49 CPUC2d 486 at Appendix A (Cal. PUC, June 3, 1993).

14 Intermedia Communications of Florida, Inc., Docket No. 921074-TP, *Final Order*, PSC-94-0285-FOF-TP (Fla. PSC, March 10, 1994).

15 Freedom Ring, L.L.C., DR 96-420, *Order No. 22,798* (NH PUC, Dec. 8, 1997).

termination liability for local services is not severable from liability for non-local services).[16]

C. Fresh Look Opportunities Are Not Uniformly Available To All American Telecommunications Consumers.

Unfortunately, the willingness or ability of State commissions to provide consumers with fresh look opportunities is not universal. The North Carolina Public Utilities Commission recently refused to provide fresh look opportunities for local ILEC customers, believing that it lacked the jurisdiction to so do. In doing so, it noted that the FCC had the opportunity to impose fresh look requirements on the competitive local telephone markets but had declined to do so.[17] Likewise, the Iowa Utilities Board concluded that competition in intraLATA and interLATA telecommunications markets could develop without fresh look opportunities and chose not to implement them.[18] In 1995, the Michigan Public Service Commission declined to provide ILEC local exchange customers fresh look opportunities for their long term contracts partly because "given the rapid developments in

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16 See Establishment of Local Exchange Competition and Other Competitive Issues, Case No. 95-485-TP-COI, *Entry on Rehearing* (OH PUC, Feb. 20, 1997).

17 Local Exchange and Local Exchange Access Telecommunications Competition, Docket No. P-100, Sub 133, *Order Dismissing Fresh Look Petition on Jurisdictional Grounds* (NCUC, May 22, 1998).

18 U S WEST Communications, Inc., Docket No. SPU-98-10, *Order* (IUB, Feb. 16, 1999).

the telecommunications industry, customers should be aware of the increasing competition in the marketplace."[19]

In light of the patchwork of approaches taken, as well as the belief taken by some State commissions that they lack authority to act, comprehensive federal action is warranted. The Commission should assume an active role in promoting the ability of consumers to benefit from competitive telecommunications alternatives by allowing a fresh look for ILEC contract or tariff provisions containing excessive termination penalties.

IV. THE FCC HAS THE AUTHORITY TO INVALIDATE EXCESSIVE ILEC TERMINATION PENALTIES.

The Commission possesses several sources of jurisdiction to invalidate excessive ILEC termination penalties. For the most part, the request made of the Commission by the KMC Petition does not require application of the 1996 Telecommunications Act. Although the FCC authority granted in Section 253 expressly applies to both interstate and intrastate telecommunications services,[20] the Commission's jurisdiction over interstate communications precedes enactment of the 1996 Amendments. As discussed below, a declaratory ruling invalidating excessive ILEC termination penalties would be part of a long-standing practice of the Commission that has been upheld by the courts.

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19 City Signal, Inc., Case No. U-10647, *Order* (MI PSC, Feb. 23, 1995).

20 47 U.S.C. § 253(a) and (d).

A. Where Interstate Communications Are Affected, The FCC's Jurisdiction Cannot Be Thwarted By Strategic Placement of ILEC Termination Penalties In State Tariffs.

The Commission should not be deterred by the possibility that some termination penalties are contained in ILEC tariffs filed with State commissions. The fact that excessive termination penalties are embedded in State tariffs does not immunize those services from assertion of Commission jurisdiction when they affect interstate communications. Termination penalties often cover a package of services including both intrastate and interstate communications and, in many instances, ILECs could just as easily have placed these provisions in federal tariffs.

To the extent that the services covered by ILEC termination penalties are, in whole or in part, interstate communications, the Commission maintains jurisdiction <u>without</u> operation of Section 253 to invalidate or abrogate excessive termination penalties, regardless of their placement in State tariffs.[21]

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21 Of course, consistent with this view is the realization that, for these purposes, no special legal significance need be attached to ILEC tariffs. As the Supreme Court explained in <u>Detroit Edison</u>, the option of implementing programs within a tariff is primarily one of the regulated entity and approval by a state commission of a utility's decision to maintain a program does not, in and of itself, implement any statewide policy regarding the same. <u>Cantor v. Detroit Edison Co.</u>, 428 U.S. 579, 585 and 594 (1976). Tariffs simply go into effect -- they do not require the affirmative approval of a State or federal regulatory commission. Consequently, the Commission should not ascribe extraordinary significance to them for purposes of this inquiry. To this end, invalidation of excessive termination penalties contained within ILEC state tariffs does not represent a preemption of the state so much as it represents an order to an ILEC to cease anticompetitive practices.

Joint commenters are not making any new claims here about the Commission's jurisdiction. The Commission's authority over certain services contained in ILEC State tariffs is consistent with a view long held by the Commission. In 1971, the Commission ordered AT&T to permit reasonable and nondiscriminatory interconnection with new carriers in the specialized communications field.[22] Although AT&T and MCI presumably began interconnection negotiations, AT&T and the Bell Operating Companies severed negotiations in 1973. In an attempt to turn the matter over to State commission jurisdiction, AT&T filed tariffs with state commissions. It claimed that it would not provide the requested interconnection to MCI until the States had approved the tariffs. The FCC Chairman, by letter order, asserted the Commission's jurisdiction over State jurisdiction with regard to AT&T's interconnection obligations.[23] In <u>Bell Telephone Company of Pennsylvania v. FCC</u>, the Court of Appeals upheld the Commission's jurisdiction over AT&T, notwithstanding AT&T's attempt to avoid the Commission's jurisdiction by filing State tariffs.[24] Similarly, in the instant matter, the ILECs cannot avoid FCC jurisdiction over termination penalties for

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22 <u>Establishment of Policies and Procedures for Consideration of Application to Provide Specialized Common Carrier Services in the Domestic Public Point-to-Point Microwave Radio Service and Proposed Amendments to Parts 21, 43, and 61 of the Commission's Rules</u>, Docket No. 18920, *First Report and Order*, 29 FCC 2d 870 at ¶ 157 (1971).

23 <u>Bell Tel. Co. of Pennsylvania v. FCC</u>, 503 F.2d 1250, 1257 (3d Cir. 1974).

24 <u>Id.</u> at 1282.

interstate communications simply by including them within State tariffs.

B. The FCC Retains Jurisdiction Over ILEC Termination Penalties That Affect Interstate Communications.

The Commission retains broad primary authority over interstate wire and radio communications that dates to the passage of the Communications Act of 1934. Section 2(a) provides the Commission's subject matter and in personam jurisdiction over all interstate and foreign communication by wire and radio, and to all persons engaged within the United States in such communication or such transmission of energy by radio.[25] The sweeping language of Section 2(a) suggests a comprehensive jurisdictional mandate. The encompassing definitions of "radio communication"[26] and "wire communication"[27] in Section 3 to

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[25] 47 U.S.C. § 152(a) ("The provisions of this chapter shall apply to all interstate and foreign communication by wire or radio and all interstate and foreign transmission of energy by radio, which originates and/or is received within the United States, and to all persons engaged within the United States in such communication or such transmission of energy by radio . . . ")(emphasis added).

[26] 47 U.S.C. § 153(33)("The term 'radio communication' or 'communication by radio' means the transmission by radio of writing, signs, signals, pictures, and sounds of all kinds, including all instrumentalities, facilities, apparatus, and services (among other things, the receipt, forwarding, and delivery of communications) incidental to such transmission")(emphasis added).

[27] 47 U.S.C. § 153(51) ("The term 'wire communication' or 'communication by wire' means the transmission of writing, signs, signals, pictures, and sounds of all kinds by aid of wire, cable, or other like connection between the points of origin and reception of such transmission, including all instrumentalities, facilities, apparatus, and services (among other things, the receipt, forwarding, and delivery of communications) incidental to such transmission")(emphasis added).

include items and services incidental to such communication further emphasize the comprehensive nature of the Commission's authority. All subsequent provisions of the Act are properly considered in the light of this expansive and flexible basis of authority.

The courts consistently and repeatedly have emphasized that Congress recognized its inability to predict developments in the dynamic sphere of communications and consequently provided the Commission with significant discretion and authority to regulate within the scope of its expertise.[28] Restrictions on the Commission's ability to address new issues or problems concerning interstate radio and wire communication would impair the realization of the Commission's mandate to safeguard and promote the public interest.

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28 See, e.g., F.C.C. v. Pottsville Broadcasting Co., 309 U.S. 134, 138 (1940)("Underlying the whole law is recognition of the rapidly fluctuating factors characteristic of the evolution of broadcasting and of the corresponding requirement that the administrative process possess sufficient flexibility to adjust itself to these factors."); see also National Broadcasting Co. v. U.S., 319 U.S. 190, 218-219 (1943)("True enough, the Act does not explicitly say that the Commission shall have power to deal with network practices found inimical to the public interest. But Congress was acting in a field of regulation which was both new and dynamic. . . . the Act gave the Commission not niggardly but expansive powers."); see also Philadelphia Television Broadcasting Co. v. F.C.C., 359 F.2d 282, 284 (D.C. Cir. 1966)("Congress in passing the Communications Act in 1934 could not, of course, anticipate the variety and nature of methods of communication by wire or radio that would come into existence in the decades to come. In such a situation, the expert agency entrusted with administration of a dynamic industry is entitled to latitude in coping with new developments in that industry").

Any review of the distribution of governmental authority over communications begins with the principle that the Commission retains exclusive jurisdiction over interstate wire and radio communications.[29] The Communications Act of 1934 contemplates a dual regulatory scheme under which States retain jurisdiction over intrastate communications and the Commission retains jurisdiction over interstate and foreign communications.[30] However, jurisdictions intersect not infrequently. The exercise of state authority over intrastate communications is permitted only insofar as it permits the achievement of the Commission's goals.[31]

The reach of the Commission's jurisdiction is broad. The nature of the communications as opposed to the physical location of facilities, determines the relevant jurisdiction.[32] Indeed, a

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29 47 U.S.C. § 152(a).

30 See 47 U.S.C. § 152; see also Louisiana Public Service Comm'n v. F.C.C., 476 U.S. 355, 360 (1986)(explaining the system of dual regulation over telephone service).

31 See Louisiana Public Service Comm'n, 476 U.S. at 374 ("it is . . . a basic underpinning of our federal system, that state regulation will be displaced to the extent that it stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress")(citations omitted); see also Computer and Communications Industry Ass'n v. F.C.C., 693 F.2d 198, 214 (D.C. Cir. 1982)("Courts have consistently held that when state regulation of intrastate equipment or facilities would interfere with the achievement of a federal regulatory goal, the Commission's jurisdiction is paramount and conflicting state regulations must necessarily yield to the federal regulatory scheme"), cert. denied, 461 U.S. 938 (1983).

32 See California v. F.C.C., 567 F.2d 84, 86 (D.C. Cir. 1977)(approving the analysis of FCC jurisdiction on the basis of "the nature of the communications which pass through the facilities [and not on] the physical location of

very limited use of a facility for interstate communications suffices to impart Commission jurisdiction.[33]

C. The FCC May Prohibit ILEC Termination Penalties For Intrastate Services Under The Impossibility Doctrine.

Application of excessive termination penalties to purely intrastate services may operate as a barrier to the provision of interstate services. Put another way, where the termination penalties for intrastate services are constructed or operate in such a manner as to render it too expensive for customers to take interstate service from competitors, the effect on interstate services justifies Commission intervention.

The Supreme Court implicitly approved FCC preemption where it was not possible to separate the interstate and intrastate components.[34] The inseparability doctrine applies not only to physical facilities,[35] but to the effect of carrier pricing

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the lines"), cert. denied, 434 U.S. 1010 (1978); see also National Ass'n of Regulatory Utility Commissioners v. F.C.C., 746 F.2d 1492, 1498 (D.C. Cir. 1984)("Every court that has considered the matter has emphasized that the nature of the communications is determinative rather than the physical location of the facilities used")("NARUC II").

33 NARUC II, 746 F.2d at 1498 ("purely intrastate facilities and services used to complete even a single interstate call may become subject to FCC regulation to the extent of their interstate use"); see also Puerto Rico Tel. Co. v. F.C.C., 553 F.2d 694, 700 (1st Cir. 1977)("no matter how frequently or infrequently a subscriber places interstate calls, he is entitled to have the conditions placed on access to the interstate telephone system measured against federal standards of reasonableness").

34 Louisiana Public Service Commission, 476 U.S. at 375 n.4.

35 North Carolina Utilities Comm'n v. FCC, 537 F.2d 787 (4th Cir. 1976), cert. denied, 429 U.S. 1027 (1976); North Carolina Utilities Comm'n v. FCC, 552 F.2d 1036 (4th Cir. 1978), cert. denied, 434 U.S. 874 (1977).

arrangements, as well.[36] Hence, if ILEC pricing mechanisms and termination penalties work together to effectively preclude customers from taking interstate services from competitive carriers, the Commission's jurisdiction to invalidate the excessive termination penalties is incontrovertible.

Pursuant to the Supremacy Clause of the Constitution,[37] federal law may preempt state law under several circumstances:

> first, when Congress, in enacting a federal statute, has expressed a clear intent to pre-empt state law; second, when it is clear, despite the absence of explicit pre-emptive language, that Congress has intended, by legislating comprehensively to occupy an entire field of regulation and has thereby "left no room for the States to supplement" federal law; and, finally, when compliance with both state and federal law is impossible, or when the state law "stands as an obstacle to the accomplishment and full execution of the full purposes and objectives of Congress."[38]

These principles apply to Commission regulations, as well.[39] Although Section 2(b) generally denies the Commission authority over intrastate communications, in the appropriate circumstances,

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36 See New York Tel. Co. v. FCC, 631 F.2d 1059, 1066 (2d Cir. 1980)(FCC jurisdiction upheld because although local exchange service was separable technologically and in terms of cost assessment, the extreme financial penalties for not taking both intrastate and interstate services together affected the conduct or development of interstate communication and encroached upon FCC authority).

37 U.S. Const., Art. VI, cl. 2.

38 Capital Cities Cable v. Crisp, 467 U.S. 691, 699 (1984) (citations omitted).

39 Id. ("'federal regulations have no less pre-emptive effect than federal statutes.'")(quoting Fidelity Federal Savings and Loan Ass'n v. De la Cuesta, 458 U.S. 141, 153 (1982)).

Commission preemption of inconsistent state regulation is permissible under the "impossibility exception."[40] Judicial interpretation guides the primary operation of Section 2(a) over Section 2(b). The D.C. Circuit explained the impossibility exception:

> FCC preemption of state regulation is . . . permissible when (1) the matter to be regulated has both interstate and intrastate aspects; (2) FCC preemption is necessary to protect a valid federal regulatory objective; and (3) state regulation would "negate[] the exercise by the FCC of its own lawful authority" because regulation of the interstate aspects of the matter cannot be "unbundled" from regulation of the intrastate aspects.[41]

The impossibility exception gives effect to the notion that "Congress has recognized the existence of areas of common national and state concern and has provided a procedure under which national primacy is recognized."[42]

The Supreme Court's decision in Louisiana is the controlling case on the impossibility exception. The Louisiana Court reviewed a Commission order preempting state rules governing the method of calculating depreciation expenses. The Court held the

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40 See North Carolina Utilities Comm'n v. F.C.C., 537 F.2d 787, 793 (4th Cir. 1976) ("we are not persuaded that section 2(b) sanctions any state regulation, formally restrictive only of intrastate communication, that in effect encroaches substantially upon the Commission's authority under sections 201 through 205)("NCUC I"), cert. denied, 429 U.S. 1027 (1976).

41 Public Service Comm'n of Maryland v. F.C.C., 909 F.2d 1510, 1515 (D.C. Cir. 1990)(citations omitted).

42 NCUC I, 537 F.2d at 794.

Commission's preemption of state depreciation rules unlawful, finding that a dual depreciation mechanism was possible through use of the separations process provided in the Act.[43] Nevertheless, the Court recognized the validity of the "impossibility exception"[44] and implicitly approved prior application of that exception by appeals courts.[45]

The identification of a "valid federal regulatory objective," to which the impossibility exception refers, rests largely with the Commission. In judicial review of the Commission's interpretation of its organic statute, the Commission is entitled to substantial deference.[46] Consequently, courts generally refrain from rejecting the Commission's interpretation of the Act's objectives (upon which its preemptive authority relies). In addition, the Commission must demonstrate that the state regulation in question negates a valid federal policy.[47]

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43 Louisiana Public Service Comm'n, 476 U.S. at 375.

44 Id. at 374.

45 Id. at 375 n.4.

46 See U.S. v. Rutherford, 442 U.S. 544, 553 (1979)(the construction of a statute by those charged with its administration is entitled to substantial deference); see also Red Lion Broadcasting Co. v. F.C.C., 395 U.S. 367, 381 (1969); see also Electronic Industries Ass'n Consumer Electronics Group v. F.C.C., 636 F.2d 689, 695 (D.C. Cir. 1980)("We accord the Commission broad discretion in implementing its controlling statutes").

47 National Ass'n of Regulatory Utility Commissioners v. F.C.C., 880 F.2d 422, 431 (D.C. Cir. 1989)("NARUC III").

While some courts have narrowly construed the impossibility exception,[48] the Commission need not demonstrate that execution of federal requirements would be rendered absolutely impossible by the state regulation. Both physical <u>and economic</u> difficulties of separation are considered.[49]

For example, in <u>Illinois Bell</u>, the D.C. Circuit upheld the Commission's preemption of state regulation of BOCs' joint marketing of CPE and Centrex services.[50] The court observed that Centrex services support both interstate and intrastate communications and that "consumers enjoy a statutory right to [the] interstate access [provided by Centrex], a right that is distinctly *federal* in character."[51] Moreover, the court contemplated a more attenuated relationship to interstate communications that would allow Commission preemption:

> [e]ven if Centrex were a purely intrastate service, the FCC might well have authority to preemptively regulate its marketing if - as would appear here - it was typically sold in a package with interstate services.

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48 <u>See</u>, <u>e.g.</u>, <u>People of the State of California v. F.C.C.</u>, 905 F.2d 1217, 1244 (9th Cir. 1990)(holding that the FCC had not justified the broad preemption provisions in its *Computer III* order sufficient to avail itself of the impossibility exception).

49 <u>See</u>, <u>e.g.</u>, <u>North Carolina Utilities Comm'n v. F.C.C.</u>, 552 F.2d 1036, 1043 (4th Cir. 1977) ("NCUC II"), <u>cert.</u> <u>denied</u>, 434 U.S. 874 (1977); <u>see</u> <u>also</u> <u>NCUC I</u>, 537 F.2d at 791 ("Usually it is not feasible, as a matter of economics and practicality of operation, to limit the use of [CPE] to either interstate or intrastate transmissions").

50 <u>Illinois Bell Tel. Co. v. F.C.C.</u>, 883 F.2d 104, 116 (D.C. Cir. 1989).

51 <u>Id.</u> at 113 (emphasis in original).

> Marketing realities might themselves create inseparability.[52]

The court viewed the controlling rationale in Louisiana as informed by the

> recognition that strict separation of state and federal regulatory spheres in some settings would require construction of wholly independent intrastate and interstate networks and facilities, a result which seems at odds with Congress' intent.[53]

Noting the absence of any practical way to divide the subject matter of the Commission's valid regulatory scheme, it approved the Commission's preemption.[54]

D. The FCC Retains Authority Under Section 253 To Invalidate Legal Requirements That Prohibit The Provision Of Intrastate Services.

Where services covered by excessive termination penalties are purely intrastate, Section 253 operates to provide the Commission authority to eliminate those penalties to the extent that their operation has the effect of prohibiting interstate or intrastate telecommunications service. Section 253(a) proscribes, inter alia, State or local legal requirements that prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.[55] By the express terms of the provision, "the

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52 Id. at n.7.

53 Id. at 116.

54 Id.

55 47 U.S.C. § 253(a).

limitation on the Commission's authority over intrastate matters, set forth in section 2(b) of the Act is inapplicable."[56]

The provision is not limited to "outright prohibitions of entry" but also

> forbids state and local governments from enforcing any statute, regulation, or other legal requirement that has the effect of prohibiting any entity's ability to provide any interstate or intrastate telecommunications service.[57]

In making this determination, the Commission considers whether the enforcement of a legal requirement "materially inhibits or limits the ability of any competitor or potential competitor to compete in a fair and balanced legal and regulatory environment."[58]

To the extent that State commissions enforce excessive ILEC termination penalties contained in ILEC State tariffs and State courts enforce the same penalties in customer contracts, they enforce legal requirements that have the effect of prohibiting competitors from providing intrastate and interstate telecommunications services. The excessive termination penalties

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56 The Public Utility Commission of Texas, et al., CCBPol 96-13, 96-14, 96-16, 96-19, *Memorandum Opinion and Order*, 13 FCC Rcd 3460 at n.105 (1997).

57 TCI Cablevision of Oakland County, Inc. Petition for Declaratory Ruling, Preemption and Other Relief Pursuant to 47 U.S.C. §§ 541, 544(e) and 253, CSR-4790, *Memorandum Opinion and Order*, 12 FCC Rcd 21396 at ¶ 98 (1997).

58 California Payphone Association Petition for Preemption of Ordinance No. 576 NS of the City of Huntington Park, California Pursuant to Section 253(d) of the Communications Act of 1934, CCB Pol 96-26, *Memorandum Opinion and Order*, 12 FCC Rcd 14191 at ¶ 31 (1997).

perpetuate the monopoly status of the incumbent. Put differently, the widespread presence and enforcement of such terms materially inhibits the ability of competitors to compete in a fair and balanced legal and regulatory environment by sustaining the advantages of incumbency. Consequently, the Commission retains the authority to invalidate excessive ILEC termination penalties pursuant to Section 253.

V. CONCLUSION

For the foregoing reasons, ALTS, Net2000, and Teligent respectfully urge the Commission to grant KMC's Petition and issue a declaratory ruling declaring unlawful excessive ILEC termination penalties and offering consumers fresh look opportunities at those penalties contained in contracts with the ILEC.

Respectfully submitted,

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